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Unthinking Financial Regulators

By Richard W. Rahn

NEW RULES OFTEN HURT LOW-INCOME AMERICANS MOST

Imagine what life would be like if you did not have a bank account and a credit or debit card. It would be much harder to pay your bills, take trips on airlines, which normally require a credit or debit card, and receive payments, just to start. The shocking thing is that more than one-quarter of all American households are unbanked or underbanked and that this number is rising, not falling, largely because of ill-thought-out financial regulation and policies.

The term “unbanked” refers to people who have neither checking nor savings accounts. “Underbanked” refers to people who have either a checking or savings account but rely on alternative services such as non-bank money orders and check cashing, payday loans, pawn shops, refund anticipation loans, etc., at least once a year. These alternative sources usually are much more costly than banking services. Banking services to lower-income people have become increasingly expensive directly because of unthinking government regulators.

Last week, headlines were filled with such items as “Bank of America to charge $5 debit card fee.” Other banks are testing or planning monthly debit card fees and/or checking account fees. These new fees are a direct response to an amendment by Sen. Richard J. Durbin, Illinois Democrat, to the Dodd-Frank Act, which limits debit card transaction fees to 21 cents per transaction. In many cases, that does not cover the bank’s cost.

President Obama again showed that he doesn’t understand economic and financial policy by attacking the banks for responding to the price-control legislation that he signed into law. He accused the banks of using the new financial regulations as an “excuse” to impose the new fees on consumers. The president, not assisted by the ever-present teleprompter, babbled, “You can stop it because it - if you - if you say to the banks, ‘You don’t have some inherent right just to - you know, get a certain amount of profit … .’ ” Karl Marx probably would have said the same thing, but in a more articulate way.

Assume you are running a business, whatever kind of business you can imagine, and suddenly the government imposes price controls on some of your products and greatly increases the cost of regulation on you and your competitors. You could do nothing and just suffer the loss of income, which probably would discourage you from trying to expand this particular business and hire new workers, or you could try to find ways around the cost of the new regulations and pass those costs on to your customers.

Politicians have been trying to impose price controls at least since the Roman Emperor Diocletian tried it in A.D. 301. It failed then, as it has every time since then over the past 2,000 years. Rent controls, which are price controls, ultimately result in slums and housing shortages. Those older than 40 years of age probably remember Jimmy Carter’s idiotic price controls on gasoline, which led to people waiting in lines for hours to get a small amount of gas. But the Obama administration and many in Congress (mainly, but not all, Democrats) seem to learn nothing from history or economic theory.

The biggest single increased cost driver for banks and other financial institutions is the avalanche of new government regulations. Who bears the cost of all these new regulations? The consumer. If banks try to absorb all of these costs, their profits will fall, which means their owners (stockholders) will move their capital elsewhere to more profitable industries, and thus banks will have less capital to protect themselves from loan losses and bad times and to hire new workers. It is low-income consumers who suffer the most. Regulatory costs to financial institutions are largely fixed in that the cost per account is roughly the same whether the account has $3,000 in it or $300,000. If the regulatory cost per account is $300, that means the cost for the $3,000 account is 10 percent, while the regulatory cost for the $300,000 account is just one-tenth of 1 percent.

In fact, many of the anti-money-laundering regulations, such as “Know Your Customer,” often have a higher cost per account for low-income people than for higher-income people. The reason is that many lower-income people are newer to the work force and have less detailed financial histories than higher-income, more established, folks, so the actual cost of due diligence is higher for lower-income people, making them less attractive customers.

As lower-income people are driven out of the banks because of ill-founded government regulation, they are forced to seek alternatives, including the use of cash, which easily can be stolen, lost or destroyed. Enlightened members of a legislative body or enlightened regulators would understand how ill-founded regulations impose great misery and risk on those least able to endure them. But the term “enlightened” and the president, Congress and the financial regulatory bureaucracy are rarely found in the same sentence.

What Congress should do is impose strict and independent cost-benefit requirements on all government regulatory agencies while at the same time giving those who suffer from ill-founded regulations the right to challenge those regulations - and the right to have their costs covered if they win.

The president’s team seems to be baffled by his fall in the polls. Could one reason be that almost every time he speaks, he shows an appalling economic ignorance? Perhaps he should speak less and use the time to read more of Milton Friedman and F.A. Hayek.

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